United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7609

United States Court of Appeals

FOR THE SECOND CIRCUIT

B

NO. 75-7609

COMPETITIVE ASSOCIATES,
Plaintiff and Appellant,

vs.

ADVEST CO.,
Defendant and Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE DEFENDANT — APPELLEE

To be argued by:
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Preliminary Statement Pursuant to Section 28, Rules of the Court of Appeals for the Second Circuit

The decision appealed from was rendered by the Honorable Robert L. Carter, District Judge on September 29, 1975. The decision has not as yet been reported officially, although the Opinion has been reported unofficially. *See Competitive Associates, Inc. v. Advest Co.*, (S.D. N.Y. Oct. 1, 1975), CCH Federal Securities Law Reporter, ¶ 95,302.

TABLE OF CASES AND AUTHORITIES

TABLE OF CONTENTS

STATEMENT OF THE ISSUES

I. Did the Trial Court correctly dismiss Competitive's fraud claims?

II. Did the Trial Court correctly dismiss Competitive's claims based on non-delivery of a prospectus?

III. Did the Trial Court properly refuse to consider Competitive's claims under the Investment Company Act and the Investment Advisors Act?

STATEMENT OF THE CASE

This action was filed in the District Court on May 4, 1972 (2a*) by Competitive Associates, Inc. ["Competitive"], and Competitive Capital Corporation, against Fire Fly Enterprises, Inc. ["Fire Fly"], Chartered New England Corp., Sherwood Securities Corp., Advest Co. ["Advest"], Provident Securities, Inc., Lewis Randolph, Clyde Davis, Lark Washburn, Monroe J. Korn, Donald A. Gary, Aaron Sobel, Carol Gary, Phillip Kaye and Pericles Constantinou.

The original complaint alleged that between January 19 and April 28, 1971, Competitive purchased securities of Fire Fly from the broker-dealer defendants and made two claims for relief. The first sought rescission of these purchases on the basis that they were not "accompanied or preceded by a prospectus", allegedly in violation of Sections 5 and 12(1) of the Securities Act of 1933, 15 U.S.C. §§ 77a, et seq. [the "1933 Act"]. The plaintiff attempted to avoid the one year statute of limitations in Section 13 of the 1933 Act, by claiming that discovery of the alleged failure to deliver a prospectus did not occur, and could not have occurred in the exercise of reasonable diligence, before June 1, 1971, due to fraudulent concealment by the defendants.

The second form of relief sought was $5,000,000 damages for alleged misstatements or omissions to state material facts in the same prospectus which was claimed not to have been received, all in violation of Sections 11, 12(2) and 17 of the 1933 Act and Sections 10(b) and 15(c) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, et seq. [the "1934 Act"].

Subsequently, an amended complaint was filed which deleted Competitive Capital Corporation as a plaintiff but which contained essentially the same claims, albeit in more

*All page references are to the Joint Appendix unless otherwise indicated.

detail, on behalf of Competitive. (9a-17a). It alleged that Competitive had purchased a total of 23,010 shares of Fire Fly from the broker-dealer defendants at a total purchase price of $140,015. It alleged further that Competitive had sold all of these shares on May 19, 1971 to one of the defendants, Chartered New England Corp., at a price of $3.50 per share for a total sale price of $80,585. Of these shares, Competitive alleged that 4,350 shares were purchased from the defendant Advest (through its Newburger and Co. division), with the remaining 18,660 shares having been purchased through two other defendant brokerage firms, Chartered New England Corp. and Sherwood Securities Corp. The amended complaint further alleged that the defendants were part of a conspiracy involving an individual, Akiyoshi Yamada, who is not a party to this action and who is described in the amended complaint as an employee of Competitive. (Para. 10, at 13a-14a).

Advest denied the material allegations of the amended complaint and also pleaded the statute of limitations as a defense. (18a-19a).

A jury trial was originally demanded by Fire Fly but was subsequently waived by all parties.

After a conference on June 10, 1974, a pretrial order was entered on October 1, 1974, setting forth certain facts not in dispute along with Competitive's claims and the issues to be tried.

Prior to trial, Competitive and various of the defendants agreed to a settlement in the total amount of $15,000. (123a). Of this sum, $7,000 was paid on behalf of the issuer, Fire Fly, and its officers and directors, Lewis Randolph, Clyde Davis, Lark Washburn, Monroe J. Korn, Donald A. Gary, Aaron Sobel, Carol Gary and Phillip Kaye, and $3,000 was paid on behalf of Sherwood Securities Corp. which had allegedly sold 9,660 shares of Fire Fly to Competitive at a total price of $60,040. The remaining $5,000 was paid in

settlement by Chartered New England Corp. which allegedly sold 8,000 shares of Fire Fly to Competitive at a total price of $40,612.50.*

Provident Securities, Inc., and Pericles Constantinou were subject to liquidation and bankruptcy proceedings, respectively, at the time of the trial. (366a). The sole active defendant when trial commenced was Advest, which was and is a broker-dealer, a member of the New York, American and other major exchanges and a member of the National Association of Securities Dealers. (*Id.*).

Trial commenced on April 16, 1975 before the Honorable Robert L. Carter and concluded two days later on April 18, the Trial Court reserving decision. (6a-7a). Post Trial Briefs were submitted by the parties. By its Opinion dated October 1, 1975, the Trial Court dismissed Competitive's claims and ordered judgment in favor of Advest. (365-377a). Pursuant to that ruling, Judgment was entered against Competitive and in favor of Advest on November 24, 1975, and the Opinion dated September 29, 1975 was constituted as the Trial Court's findings of fact and conclusions of law. (379a). Competitive appealed by Notice of Appeal dated October 30, 1975. (378a)

*Settlement information supplied by counsel for plaintiff after the trial. *See* 124a; *see also*, counsel's letter to Honorable Robert L. Carter, May 27, 1975, in record below but not included in Joint Appendix.

STATEMENT OF THE FACTS

I. Competitive and Yamada

Competitive represented itself in its prospectus to be "an investment company with independent competitive multiple management". (*See* 365a; Exhibit G [not reproduced in Joint Appendix]). Competitive employed and paid management fees to Competitive Capital Corporation as its fund manager. (301a).

Pursuant to the agreement with its fund manager, Competitive distributed its assets among separate portfolio managers for investment. The primary function of the portfolio managers was to select securities to be purchased and sold by Competitive. The various portfolio managers "competed" with each other and their compensation was based in part on relative performance. (*See* 300a; Exhibit G).

In 1970, negotiations between Competitive and Akiyoshi Yamada, principal of a firm known as Takara Asset Management Co., Inc. ["Takara"], led to an agreement by which Takara became one of Competitive's portfolio managers. (366a).

On October 9, 1970, the appointment of Takara, i.e. Yamada, as a portfolio manager was approved at a meeting of Competitive's shareholders in Beverly Hills, California. (Exhibit C, 291a) (For all practical purposes Takara may be considered the alter ego of Yamada. [*See* 366a]). A Portfolio Management Agreement was executed on that date by Competitive, Competitive Capital Corporation, and Yamada. (Exhibit F, at 304a-309a).

On this same date, October 9, 1970, Competitive's Board of Directors met in New York City. (Exhibit V, at 355a-363a). Richard Boesel, a director of Competitive, inquired at that meeting as to rumors of an SEC investigation of Yamada. (*See* 367a; Exhibit V, at 357a). Although not

reflected in the minutes of that meeting, it seems clear from the minutes of the subsequent directors' meeting that on October 9, 1970 the Board directed Competitive's officers to conduct an investigation of these rumors. (Exhibit H, at 311a). During the period of Yamada's employment by Competitive, however, neither the minutes of the meetings of Competitive's shareholders nor of its directors reflect any disclosure of this information, or any information of a similar nature concerning Yamada, to Competitive's shareholders.

Several paragraphs of the Portfolio Management Agreement between Competitive and Yamada are of special significance. (367a). Paragraph 5 specifically provided that "[t]he Portfolio Manager may, in the rendition of its services hereunder, obtain information and/or assistance from any persons, firms or corporations that it deems reliable, on such terms as it desires and determines in its discretion. . . ." (Exhibit F, at 306a).

Paragraphs 16, 18 and 23 of the Portfolio Management Agreement expressly permitted Yamada to buy, sell or trade securities for his own account or for the account of any person, firm or corporation in which he or Takara had an interest or with which they were affiliated. (*Id.*, at 308a, 309a). The Agreement expressly permitted Yamada to act as investment advisor to other persons, firms or corporations and to perform management and other services for third parties without thereby incurring liability to Competitive or the Fund Manager. (*Id.*, para. 18, at 308a). Virtually the only restriction on Yamada was that he was prohibited from rendering investment advisory or related services to other multiple management investment companies with independent portfolio management. (*Id.*, para. 23, at 309a). As Competitive told prospective investors in its own prospectus:

> The portfolio managers presently serve as investment advisors to other persons, but have agreed not to ren-

> der such services to any multiple management investment company without written consent of the fund manager. . . . (Exhibit G, at 11 [not included in Joint Appendix]).

Competitive did not prohibit its portfolio managers from advising clients on the opposite side of transactions involving Competitive, but actually contemplated that they would do so. As was stated in a letter to Yamada from Alan Markizon, Competitive's Corporate Secretary, the only requirement in such instances was that Competitive be notified in writing subsequent to the transaction. (Exhibit B, at 287a; *see also,* Exhibit K, para. 3, at 324a).

Competive's portfolio managers, such as Yamada, did not buy and sell securities directly for its account. This function was performed by Competitive's traders who acted upon the instructions of the portfolio managers. (*See* Exhibit I, at 322a)

Yamada had a high reputation in the financial community in October, 1970 when he became a portfolio manager for Competitive. (376a; *see also,* attachment to minutes of Competitive directors' meeting, Exhibit A, at 266a-267a; *see also,* testimony of: William H. Davis at 58a; Peter N. Engelbach at 99a, 131a, 137a; Jack Shaw at 197a-198a). Yamada graduated from the Harvard Business School and in 1965 joined the noted New York investment banking firm of Kuhn, Loeb & Co. where he quickly advanced to become senior analyst and the youngest assistant vice-president in that firm's history. He left Kuhn, Loeb in 1969 to form his own hedge fund, Takara Partners. (Exhibit A, at 267a; *see also,* 366a).

II. Peter Engelbach

In 1965, when Yamada first joined Kuhn, Loeb, & Co., he met and developed strong professional and personal ties with a fellow employee at that firm, Peter N. Engelbach ("Engelbach"). (367a). Engelbach left Kuhn, Loeb in 1966

to engage in the sales aspect of the brokerage business in the Philadelphia area. At the time of trial, Engelbach was a registered representative of Thomson & McKinnon, Auchincloss, Kohlmeyer, Inc., a member firm of the New York Stock Exchange (363a, 128a-129a). Engelbach continued his friendship with Yamada after leaving Kuhn, Loeb. (130a) When Engelbach left New York he developed a business relationship with Yamada and they were in daily contact by phone, in part because Engelbach was able to supply up-to-date quotation data. (367a-368a; *see also,* 132a-135a). Yamada, from time to time, recommended Engelbach as a broker to a number of individuals. (368a; *see also,* 130a, 135a). In 1969, Engelbach and members of his family together invested $100,000 for a limited partnership interest in Takara Partners. (368a; *see also,* 90a-91a).

III. Competitive's Early Awareness of Problems With Yamada

On January 13, 1971, several disturbing matters involving Yamada were raised at a meeting of Competitive's Board of Directors. (370a). These included that the SEC was investigating Yamada personally and a company of which he was an officer in connection with artificial manipulations of 13 stocks, three of which were then included in Competitive's portfolio; that he had received consideration for recommending certain stocks and that he received undisclosed profits from trading in these stocks; that he was involved with fictitious orders; and that a lawsuit had been filed against Yamada concerning fraudulent purchases of securities. The concern of the Board was so great that Yamada had been invited to attend the meeting along with his counsel. (Exhibit H, at 311a-312a, 315a-321a).

No action was taken by the Board as to Yamada at that meeting. On February 8, 1971, Markizon was in communication with Mr. Irwin M. Borowski, SEC Branch Chief, Division of Trading and Markets, with regard to the SEC's

interest in Takara. (371a; *see also,* Exhibit I, at 322a) (Evidently, Markizon and Ezra Levin, Competitive's Counsel, had previous contact with the SEC concerning Takara's activities. *Id.*).

Competitive elected to meet its record keeping obligations under the Investment Company Act of 1940 by having its portfolio managers, including Yamada, maintain research files concerning securities purchased by Competitive, with a provision for immediate access to such records by Competitive. (Exhibit B, at 288a; Exhibit K, at 324a). In spite of this "immediate access" requirement, Competitive officials never reviewed any records maintained by Yamada until immediately before the Board meeting of May 12, 1971. (*See* Exhibits K, at 323a-332a; L, at 333a; M, at 341a-343a; S, at 352a).

IV. The Fire Fly Purchases

A. The Public Offering

The public offering of Fire Fly became effective on January 4, 1971, with Provident Securities, Inc., originally a defendant herein, as the underwriter. (Exhibit 11, at 232a-252a). At that time, Engelbach was a registered representative in the Philadelphia office of the brokerage firm of Woodcock, Cummings, Tayor and French, a non-participant in the offering. (368a; *see also,* 108a).

Yamada had discussed the investment merit of Fire Fly with Engelbach prior to the effective date of the offering. He was very enthusiastic about Fire Fly's potential and told Engelbach that the president of Fire Fly was a noted Utah geologist who had developed a technique to reopen and economically develop previously worked-out mines. (141a-142a; Exhibit 11, principally 234a-242a). Thereafter, Yamada sent Engelbach a Fire Fly final prospectus. (372a; 143a-144a). Engelbach passed this recommendation along to several of his customers who were interested in making

investments on Yamada's advice. Some of these customers purchased Fire Fly stock through Engelbach, not in the initial offering, but in the after-market. (144a). All such transactions took place prior to Engelbach's employment with Advest in March, 1971. (64a, 137a).

B. Purchases of Fire Fly by Competitive

Yamada apparently initiated several purchases of Fire Fly stock for Competitive prior to the transaction in question. On January 19, 1971, 3,100 shares were purchased by Competitive from Chartered New England Corp. at 5½, and 2,900 additional shares were purchased from Chartered New England Corp. at 4⅝. A third purchase from Chartered New England Corp. was made on February 1, 1971, in the amount of 3,000 shares at 5¾. On February 2, 1971, Competitive purchased 3,000 shares at 5¾ from Sherwood Securities. (Amended Complaint, para. 4, at 11a-12a).

C. The Advest Sale

On or about April 1, 1971, Yamada called Engelbach, then employed as a salesman by Advest, and asked him whether those of his customers who owned Fire Fly stock would be interested in selling. Yamada stated that Competitive was interested in acquiring ". . . a rather large block of Fire Fly." (69a).

While Engelbach was aware that Competitive's investment goal was an aggressively managed portfolio for capital appreciation, (*see* Exhibit G), he did not know the specific composition of Competitive's portfolio (including its prior purchases of Fire Fly) since Competitive kept this a very closely guarded secret. (87a).

After the April 1, 1971 call from Yamada, Engelbach contacted various of his customers who then held Fire Fly and inquired whether they were interested in selling. Some sold and others chose not to sell. (369a; *see also* 54a, 70a).

Engelbach informed Yamada that 4,350 shares of Fire Fly were available for sale, (77a, 81a), and Competitive's trader then placed an order for the purchase of these shares. (78a).

Engelbach spoke with his supervisor at Advest, Samuel Switsky, before accepting Competitive's order. Switsky in turn, before giving his approval, spoke with a partner of Advest, Alan Weintraub, who took the precaution of initiating a call to Competitive's trader to verify the order. Having thus verified the transaction with Competitive, Advest purchased the shares from the individual customers at 6½ and resold to Competitive at 6¾. (370a; *see also,* 74a-77a, 81a). This transaction was accomplished on a "principal" rather than an "agency" basis at the direction of Competitive which, as a regulated investment company, was required to obtain the "best price" on every transaction, i.e. without a commission. (151a-152a). The gross profit to Advest was the quarter of a point mark-up, substantially less than would have been realized in commissions had this been an agency transaction. (156a). Engelbach was allocated 40% of the mark-up of $1,087.50. (166a). There was absolutely no other benefit either to Advest or to Mr. Engelbach as a result of this transaction. (167a-169a).

A prospectus was not sent by Advest with its confirmation slips for the transaction of April 2, 1971, since Competitive's own employee, agent and portfolio manager, Yamada, already had this prospectus and was the source from which it had been obtained by Engelbach. (372a; *see also,* 143a-144a)*.

As a result of the Fire Fly transactions, Engelbach's individual customers in some cases realized a modest profit, in other cases none. (Exhibits 4, 5, at 221a-223a, 214a).

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*In addition, there was testimony that two months earlier Competitive had been sent a Fire Fly prospectus with its prior purchase of that stock from the Chartered New England firm. (*See* testimony of Elgin Cary, at 103 of trial transcript [not printed in Joint Appendix]).

V. Termination of Yamada by Competitive

At its May 12-13, 1971 meeting, Competitive's Board voted to terminate Yamada as a portfolio manager. (Exhibit M, particularly 342a). At no time was any of the information considered by Competitive during the prior several months concerning the conduct of Yamada conveyed to those doing business with Competitive, such as Advest and Engelbach. (162a-165a). Neither was this information disclosed by Competitive to its own shareholders. (*See* Exhibits C, at 289a-303a and G; *see also*, Exhibits H, at 310a-321a and M, at 334a-346a).

VI. Competitive's Sale of Its Fire Fly Holdings

At the May 12-13, 1971, meeting, Competitive's Board ordered the immediate sale of its holdings of two securities, including the 23,010 Fire Fly shares, in that portion of its portfolio theretofore managed by Yamada. (Exhibit M, at 342a-343a). This sale was accomplished on May 19, 1971 through the sale of the entire block, which amounted to almost 25% of the total public issue of 100,000 shares, at 3½. (23a, 27a). Competitive's trader, McSwain, in testimony before the SEC, stated that he thought the manner of disposing of its holdings was "ridiculous" and that Competitive's directors dropped the stock in order "to try to protect themselves". (Exhibit R, at 349a-350a).

According to Competitive's financial statements, its holdings of Fire Fly on May 14, 1971 the day after its directors had decided to sell the entire block, had a market value of $135,183, i.e., approximately $5.87 a share and only $4,832 below its actual purchase price. (Exhibit N, at 347a).* As for alleged losses with respect to its Fire Fly holdings, Competitive has received compensation in the total amount of $15,000 by reason of settlements reached with eleven of the original defendants in this action. (124a).

*The market price of Fire Fly rebounded sharply after the sale of Competitive's holdings on May 19. For example, the price of Fire Fly, as reflected in the "Pink Sheets" (Exhibit W, [not reproduced in Joint Appendix]), was between 5½ and 6½ on May 24, 1971.

ARGUMENT

I. The Trial Court Correctly Dismissed Competitive's Fraud Claims.

A. Competitive Failed to Establish Participation by Engelbach in Any Fraudulent Actions of Yamada

As noted at page 4 of its Brief, Competitive has completely abandoned the claim alleged in its amended complaint that Advest participated in a broad-based conspiracy to manipulate the public offering of Fire Fly. Competitive now relies on an entirely different "scheme": the use of Competitive as a "dumping ground" for Fire Fly after Yamada had artificially manipulated the market price of Fire Fly in order to induce investments by third parties in other Yamada vehicles. (*See* Competitive's Brief, at 15-16). Not only has this claim not been raised previously, it finds no support whatsoever in the evidence.

Advest concedes that Yamada was an unfaithful employee of Competitive. At trial, however, Competitive actually produced little or no specific evidence of wrongdoing even on the part of Yamada regarding purchases of Fire Fly. This paucity of support in the record perhaps explains Competitive's resort to speculation on almost every page of its Brief.

In order to recover from Advest, Competitive had the evidentiary burden of establishing the actual participation of Engelbach, with the requisite degree of *scienter,* inYamada's alleged scheme. Quite simply, Competitive failed to meet this burden at trial. The findings by the Trial Court that "Engelbach's role has not been shown to be sinister in this transaction," and "[t]he facts before me appropriately add up to Engelbach and Competitive being duped by Yamada," demonstrate Competitive's utter failure to meet its burden of proof as to the issue upon which its entire fraud case rests. (376a).

The core of Competitive's theory, as the Trial Court correctly analyzed, is that ". . . Engelbach and therefore Advest committed a 10b-5 violation in buying Fire Fly's stock from Yamada's customers and selling that stock to Competitive without disclosing to Competitive that Yamada was in effect both a buyer and a seller." (375a). For good reason, the Court below found that Competitive failed to establish this claim and concluded that there was ". . . no actionable fraud on Advest's part." (377a).

Competitive cannot complain that it was defrauded because Yamada advised other accounts since, as the Trial Court found, Competitive's contract with Yamada clearly envisioned that he would advise such outside accounts. (375a; *see also,* 300a, 308a). The additional finding that Competitive specifically contemplated conflicts between Yamada's private accounts and his role as portfolio manager also is amply supported in the record. (324a). In its contract with Yamada, Competitive could have prohibited transactions in which Yamada advised both the buyer and seller. Instead, it explicitly elected not so to do, requiring merely that Yamada, and its other portfolio managers, report such transactions after the fact. (*Id.;* Competitive never attempted at trial, it should be noted, to establish that Yamada failed to comply with this internal reporting requirement.).

Competitive does not seriously contend that it was defrauded because it purchased stock which was acquired from individuals who were also advised by Yamada. Indeed, as the portfolio management system was of its own design, Competitive is hardly in a position to make such a claim. Rather, the illusory peg upon which Competitive attempts to hang its fraud claim is the non-disclosure of Yamada's dual role in this transaction.

Competitive, like all corporations, can act only through the human beings who are its agents. The Trial Court found, with ample support in the record including the

language of the amended complaint, that Yamada was Competitive's agent with specific authority to purchase and sell securities for Competitive. (373a). There is no claimed failure of Advest to make full disclosure to Yamada of all relevant circumstances of the trade. Assuming, therefore, that the claimed duty to disclose existed, it was discharged by disclosure to Yamada, Competitive's agent and employee.

Advest agrees that if Engelbach knowingly participated with Yamada in a scheme to keep information from Yamada's superiors at Competitive it cannot claim that disclosure to Yamada was disclosure to Competitive. The Trial Court found, however, that Competitive failed to show that either Engelbach had any such knowledge or that he knowingly participated in any fraudulent activity of Yamada. (376a). In good faith, however misplaced, Engelbach dealt with the agent held out by Competitive and both he and Advest were entitled to conclude that Yamada was properly attending to Competitive's affairs.

Competitive made no effort at trial, either by way of testimony from its present or former officers, directors or employees, or otherwise, to show that Yamada's knowledge was not in fact generally shared with others at Competitive. As previously noted, Competitive had an internal procedure by which portfolio managers were required to report and explain transactions in which Competitive and a private client were on opposite sides. (324a). The record shows no failure to comply with this requirement.

By failing to establish the crucial nexus between Yamada's activities and Engelbach, all of Competitive's fraud claims must fail and on this basis alone the Trial Court properly dismissed those claims.

B. Competitive Failed to Establish the Elements of a Cause of Action Under Any of the Anti-Fraud Provisions of the Securities Laws

The acts which Competitive claims give rise to the causes of action under Section 10(b) and 15(c) of the 1934 Act are the same as those which it claims support a cause of action under Section 17(a) of the 1933 Act. For the sake of simplicity, Advest will treat those claims concurrently, as did Competitive.

Competitive argues that because the Trial Court found nothing, "sinister" or "untoward" in Engelbach's actions, and failed to distinguish the cases cited in its Brief, the Trial Court failed to analyze properly its anti-fraud claims. This approach overlooks the fundamental failure of Competitive, as noted above, to meet the threshold evidentiary burden as to Engelbach's participation in Yamada's supposed scheme. The adjectives used by the Court to describe Engelbach's conduct are merely illustrative of this crucial gap in the evidence. Even if the Trial Court had, however, engaged in the lengthy analysis urged by Competitive in its Brief, the dismissal of the anti-fraud claims could not be disturbed.

To establish liability under Section 10(b) of the 1934 Act, Competitive was obligated to demonstrate that the alleged omission or misstatement relied upon involved a material fact. *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973). "The concept of materiality focuses on the weightiness of the misstated or omitted fact and a reasonable investor's decision to buy or sell." *Id.*, at 352. Concededly, Advest's failure to disclose its participation in a manipulation of the market in Fire Fly would satisfy the concept of materiality. However, the alleged nondisclosure of the fact that Yamada advised both sides of the April 2, 1971, trade involving Competitive would not meet the weightiness standard. Competitive, as demonstrated above, had specifically authorized Yamada

to deal in precisely such a manner and it follows that disclosure of such activity in this case would have made no difference to Competitive.

It is also questionable whether Competitive has met the causation-in-fact test set forth in *Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974). Competitive was required to establish at trial that it would have been influenced to act differently than it did had disclosure been made of the fact undisclosed. This is an additional evidentiary burden not met by Competitive. In this case, Competitive offered no evidence from any present or former employee on this or any other point and, had the Trial Court ever reached this issue, it would have been forced to resort to mere speculation.

In order to recover in this Circuit, the plaintiff must establish the element of *scienter*. Although it is true that actual "evil motive" need not be established, something more than negligence must be proven. *Republic Technology Fund, Inc. v. Lionel Corp.*, 483 F.2d 540 (2d Cir. 1973); *Lanza v. Drexel & Co.*, 479 F.2d 277, 1305 (2d Cir. 1973). Once again, Competitive utterly failed to meet its burden on this issue.

Finally, in spite of the vast number of cases as to brokers' liability which have been decided by the courts during the last generation, Competitive rests its case on three thirty-year old administrative decisions which are not in point. *William I. Hay*, 19 S.E.C. 397 (1945); *Oxford Co., Inc.*, 21 S.E.C. 681 (1946); and *Norris & Hirschberg, Inc.*, 21 S.E.C. 865 (1946); *aff'd sub nom. Norris & Hirschberg, Inc. v. S.E.C.*, 177 F.2d 228 (D.C. Cir. 1949).

The facts presented in this case are hardly analogous to those in the three administrative actions relied on by Competitive. Here, an investment company placed an unsolicited order to buy a security from a member of the New York Stock Exchange and insisted that the trade be made on a principal rather than an agency basis. Competitive

knew at the time the trade was made that Advest was selling securities for its own account. Compare this situation to that which confronted the Court of Appeals in *Norris & Hirschberg, Inc. v. S.E.C., supra,* where the broker-dealer "whipped" unlisted securities back and forth between the accounts of elderly widows and other "naive" investors who had "with absolute and blind confidence" entrusted their funds to the broker in question. No such relationship existed between Competitive and Advest and Advest's execution of this trade as principal was perfectly proper under the circumstances.

If there is one conclusion to be reached after a review of this record, it is that Competitive's theories about the manner in which it was defrauded were not supported by credible, persuasive evidence at trial. The Trial Court properly dismissed Competitive's anti-fraud claims.

II. The Trial Court Correctly Dismissed Competitive's Claims Based on Non-Delivery of A Prospectus

A. Statute of Limitations

The Trial Court concluded that Competitive's claims based on non-delivery of a prospectus were barred by the statute of limitations contained in Section 13 of the 1933 Act.

Although not explicitly delineated as such, it seems clear, at least from the prayers for relief, that the amended complaint set forth two causes of action: the first for non-delivery of a prospectus in violation of Section 5 of the 1933 Act, the second for violation of certain specified anti-fraud provisions of both the 1933 and 1934 Acts. (9a).

The remedy for a violation of Section 5 is created by Section 12(1) of the 1933 Act. Section 13 of the 1933 Act is clear and unambiguous in barring any action " . . . to enforce a liability created under Section 12(1), unless brought within one year after the violation upon which it is based." The alleged violation of Section 5 by Advest took place on

April 2, 1971, and the commencement of this action on May 4, 1972 was well beyond the exiration of the one year period.

Unlike the limitations period prescribed for an action to enforce a liability created under Sections 11 or 12(2) of the 1933 Act, the language of Section 13 establishing the time within which a claim may be brought based upon Section 12(1) does not permit consideration of when the alleged violation in fact was discovered or when it should have been discovered. *Moerman v. Zipco, Inc.*, 302 F. Supp. 439, 445 (E.D.N.Y. 1969), *aff'd* 422 F.2d 871 (2d Cir. 1970). In any event, no evidence on this point was offered at trial.

The only exception to the one year limitations period for bringing an action under Section 12(1) is a situation where the alleged violation is shown to have been concealed fraudulently. *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1054 (2d Cir. 1969). Indeed, Competitive realized its predicament early on for it alleged in the amended complaint that the failure to deliver a prospectus was "[u]pon information and belief . . . an explicit, conscious deception of the plaintiff. . . ." (Para. 6, at 12a). Competitive's allegation of fraudulent concealment created, as Competitive well knew, an affirmative burden upon it to establish the facts necessary to sustain the claim. *Competitive Associates, Inc. v. Fantastic Fudge, Inc.*, 58 F.R.D. 121, 124 (S.D.N.Y. 1973). However, Competitive introduced no evidence on this issue at trial and no serious effort is made in its Brief to support this claim. Rather, Competitive seeks to have this Court rewrite Section 13 to eliminate the separate limitations period established for actions brought under Section 12(1). Such a plea more appropriately should be brought to the Congress rather than this Court.

B. Competitive Had Received a Prospectus Prior to April 2, 1971.

While the conclusion of the Trial Court that Competitive's prospectus claims were time-barred is dispositive,

its Opinion provided alternative grounds for dismissal which are equally effective in dispensing with this aspect of the case.

Both by judicial admis a and uncontroverted evidence at trial, the fact that Competitive had received a prospectus prior to April 2, 1971, has been conclusively established. The fact that the prospectus was received from a source other than Advest does not defeat the conclusion that the delivery requirements of Section 5 were satisfied. As Professor Loss points out, there is no requirement that the buyer must have received the prospectus from the particular seller; receipt of a prospectus from *anyone* is sufficient. Loss, SECURITIES REGULATIONS, 246, 250 (2d Ed. 1961). The SEC interpretation accords with that of Professor Loss. Securities Act Release No. 33-828, 17 C.F.R. § 231.828; Securities Act Release No. 33-2623, 17 C.F.R. § 231.2623, Question 5.

Competitive alleged in its amended complaint that it "acted in reliance upon the prospectus" in purchasing shares of Fire Fly. (Para. 13, at 6a). Reliance obviously connotes possession since Competitive could hardly rely on something it had never seen. The allegation of reliance constitutes a judicial admission and was, in and of itself, sufficient basis for the Trial Court to have concluded that Competitive had received the prospectus prior to the Advest transaction. "Indeed, facts judicially admitted are facts established not only beyond the needs of evidence to prove them, but beyond the power of evidence to controvert them." *Hill v. Federal Trade Commission*, 123 F.2d 104, 106 (5th Cir. 1941.)

Finally, there was uncontroverted testimony that Chartered New England Corp. had sent Competitive a prospectus several months prior to the Advest sale and that Yamada had provided Engelbach with a prospectus. (Trial Transcript, at 130 [not produced in Joint Appendix]; 143a-144a). In taking issue with Engelbach's testimony that

Yamada had sent him a prospectus, Competitive has erroneously stated in its Brief that there was no showing either as to when Yamada sent Engelbach the prospectus or whether the prospectus sent was a final prospectus. (Plaintiff's Brief, at 35). The transcript shows, to the contrary, that a *final* prospectus was sent to Engelbach by Yamada *prior* to the time that Engelbach became employed by Advest, which of course was prior to the sale by Advest to Competitive. (143a-144a).

Competitive disingenuously makes the claim in its Brief that Yamada was not its employee. (Plaintiff's Brief, at 35). Again, there is a judicial admission by Competitive to the contrary in the amended complaint which affirmatively avers that Yamada ". . . was an employee of the plaintiff." (Para. 10, at 14a). On this basis alone the Trial Court could properly have concluded that because Yamada had received a prospectus, so did Competitive. *Hill v. Federal Trade Commission, supra.*

The Trial Court properly dismissed Competitive's cause of action based on non-delivery of a prospectus by Advest.

III. The Trial Court Properly Refused to Consider Competitive's Claims Under the Investment Company Act of 1940 and the Investment Advisors Act

The impropriety of Competitive's claims under the Investment Advisors Act of 1940, initially made in its Post Trial Brief, is exceeded only by Competitive's assertion of a cause of action under the Investment Company Act for the first time on this Appeal. Neither of these claims were made in the original or amended complaint, at pretrial or during the course of trial itself. At no time did Competitive seek leave to amend either its complaint or the pretrial order to include consideration of such issues. The attempt to insert these new causes of actions into the case occurs far too late. *Harling v. United States,* 416 F.2d 405 (9th Cir. 1969), *cert. denied,* 397 U.S. 917 (1970).

Further, Competitive has utterly ignored the requirements of Rule 9(b) of the Federal Rules of Civil Procedure which requires that all allegations of fraud be stated with particularity. The particularity requirement of Rule 9(b) explicity has been held to be applicable to actions brought under the various anti-fraud provisions of the securities statutes. *Shemtob v. Shearson Hammil & Co.*, 448 F.2d 442, 445 (2d Cir. 1971); *see also, Competitive Associates, Inc. v. Fire Fly Enterprises, Inc.*, 59 F.R.D. 336, 337 (S.D.N.Y. 1972). Both the amended complaint and the pretrial order are barren of any mention of a claim that Competitive was relying on either the Investment Company Act or the Investment Advisors Act.

Competitive's belated attempt to find new causes of action, first after trial and now on appeal, is precisely the type of conduct condemned by this Court in *Segal v. Gordon*, 467 F.2d 602, 607-08 (2d Cir. 1972). Competitive has assigned error in the Trial Court's refusal to consider its claim under the Investment Advisors Act. The Trial Court had no more obligation to consider that claim than does this Court to entertain the tardy assertion of liability under the Invesment Company Act.

CONCLUSION

The decision of the Trial Court to enter judgment for Advest and to dismiss Competitive's claims of fraud and non-delivery of a prospectus, while refusing to consider its claims under the Investment Company Act of 1940 and the Investment Advisors Act, should be affirmed.

Respectfully submitted,

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